The World Bank failing to deliver real change on conditionality

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With the endorsement of Oxfam America

Why economic policy conditionality doesn't work?

The World Bank's practice of economic policy conditionality - tying its aid to the implementation of certain policies by the recipient country - has long been a contentious issue. Civil society organizations, southern governments and academics have criticised the Bank's use of policy conditionality and, in particular, its use of economic policy conditionality, for being ineffective, undermining country ownership, and imposing inappropriate policy choices.

For many years economic policy conditionality – such as privatization or liberalization - has undermined the development of domestic accountability relationships. Such conditionality takes policy decisions away from sovereign governments and places them in the hands of unelected donor officials. This means that citizens often cannot tell who made policy choices, and who to blame when things go wrong. When policies are imposed from outside the country, government commitment tends to be lower. Frequent disputes about whether conditionality has been properly implemented make aid flows to impoverished countries very unpredictable. Conditionality also imposes huge transaction costs on often already over-burdened government administrations.

We are not opposed to privatization or liberalization per se. In some instances it might be the correct policy. However, this is a decision for national governments to take, in consultation with domestic stakeholders. It is not appropriate for this to be attached to a World Bank programme.

"Policy conditionality…is both an infringement on sovereignty and ineffective" noted the Africa Commission in 2005, whilst the G8 in that same year highlighted that it was the right of sovereign nations to determine their own economic policies. In response, the British and Norwegian governments have developed policies to end the tying of their aid to privatization and liberalization conditions.

Moreover, some economic policies promoted by the World Bank through conditionality have often been disastrous for poor people. Rushed privatizations and liberalizations have often undermined the access of poor people to basic services and have painfully increased the vulnerability of already weak economies. World Bank grants and loans should not impose economic policy conditions, which too often determine sensitive policy choices.

We recognise that Congress, as other parliaments, does not want to sign blank cheques, and that some forms of conditionality are therefore desirable. The Bank should introduce a set of responsible financing standards which are mutually agreed by the Bank and recipient countries. These should be aimed at ensuring due-process obligations, such as transparency and compliance with national democratic mechanisms for public consent, and respect for internationally agreed standards and development goals. The Bank should also explore the use of outcome-based conditions.

The rise of economic policy conditionality

In the early 1980s, the World Bank's portfolio shifted from support for discrete projects towards programme financing, so-called structural adjustment loans. Rather than finance the opening of a new mine, the Bank would back reform of the mining sector, or more broadly still, reform of the business climate in an attempt to encourage foreign mining companies to invest.

World Bank started to attach numerous economic policy conditions to its grants and loans, a practice that continues to this day. For example, the requirement that “Good faith negotiations are reached for the privatization of Rwandatel, Rwandex, and Nshili-Kivu tea plantation and initiate privatization process of rice factories of Rwamagana, Gikonko and Bugarama” (Poverty Reduction Support Credit II for Rwanda, 2005); “Issue tender for the selection of a private operator for the management of the electricity sector” (Poverty Reduction Support Credit IV for Burkina Faso, 2006); or “Adopt policies to encourage the participation of non-state establishments in the delivery of public services” (Poverty Reduction Support Credit 6 for Vietnam, 2007).[1]

With this shift, the portion of the Bank's portfolio directly governed by its social and environmental ‘do-no-harm’ policies declined, whilst that which involves active interventions into state sovereignty and policy-making grew. The number of conditions attached to the Bank’s grants and loans peaked in the second half of the decade of the 1990s, with an incredible average of fifty conditions per loan given by the World Bank’s concessional arm, the International Development Association (IDA).

In 2005, in the face of growing criticisms from NGOs such as Eurodad and Oxfam, and from legislators such as yourselves, the World Bank announced reforms. It adopted a new set of “Good Practice Principles” (GPPs) that were intended to govern the way Bank staff apply conditionality. These principles aimed to reduce the overall number of conditions attached to Bank lending and ensure that those attached respected and were drawn from nationally developed poverty plans in recognition that developing country ownership is the bedrock of successful development.

Is economic policy conditionality still a problem?

Eurodad has had an opportunity to study the World Bank’s own database of conditions up to 2007. The results are in our report Untying the Knots, published last November. Its conclusions are that: Two years on from implementing the GPPs, World Bank data shows a reduction in the overall number of conditions attached to World Bank finance (from 46 per loan prior to the GPPs, to 37 per loan today). However, these numbers should be treated with caution as they paint an overly optimistic picture. This is because in some cases, the Bank is “bundling” numerous policy actions into one overall condition. For example, according to Bank data, Uganda has only eleven conditions in its PRSC V. However, when Eurodad counted the policy actions contained within each of these conditions, they found that Uganda actually had thirty-eight separate policy conditions. In a sample of 1,341 Bank conditions, Eurodad found that almost 7 per cent of Bank conditions contained multiple policy actions. If these are counted as separate condition, the number of overall conditions increases by 12 per cent.

What is clear, however, is that the GPPs have so far completely failed to make inroads into reforming the Bank’s use of policy conditions in sensitive areas such as privatization and liberalization. This report shows that **71% of all grants and loans contained some sort of sensitive policy reform**, such as price liberalization, privatization, public enterprise restructuring, commodity price regulation and subsidies, trade

[1] Policy conditions stipulate that an aid recipient implement reforms in domestic policies such as public sector wage levels or subsidies to industry. They are commonly sub-divided into economic and governance conditions, though in practice the distinction is difficult to maintain. Process conditions relate to transparency, participation and accountability. They are less intrusive. Outcome conditions require that a government reach a certain goal to keep the aid money flowing. This may be an internationally-agreed target (such as the Millennium Development Goals), a donor priority, or, ideally, a priority of the citizens of the recipient country. Outcome conditions are meant to allow the government to determine the policies and institutions which it believes are appropriate to reach the specified outcome.

reforms and tariff reductions. The majority of sensitive policy reforms are privatization-related conditions. **12 out of the 16 countries assessed by Eurodad had privatization related conditions.**

Economic policy conditions – which include privatisation and liberalisation – have remained virtually unchanged, if taken as a percentage of overall Bank conditions. This lack of change in the proportion of economic policy conditions reveals that though the Bank might be willing to reduce other conditions in other areas, it is unwilling to relinquish its influence on the economy of poor countries via economic policy conditionality. Eurodad found that countries on average receive 11 economic policy conditions per loan. And as a percentage of overall conditions, Eurodad found that **economic policy conditions have risen since the GPP was implemented and now constitute a quarter of all World Bank conditions**.

The Bank does not seem to be listening to the findings of its own 2005 Conditionality Review, when it recognised that "The lessons of the 1990s show that generalised policy prescriptions often fail, and that there is no single model of development".[2]

What is wrong with privatization and sensitive economic policy reform conditions?

State-owned enterprises in poor countries receiving World Bank's grants and loans are often inefficient and a burden to the government's budget. Likewise, provision of utilities such as water and electricity, as well as of essential services such as health and education does not reach a good share of the population – particularly the poor – and the quality does not meet the minimum standards. Reform is certainly needed.

However, all too often privatization promoted by the World Bank through conditionality has led to disastrous results for poor people. Rushed privatisations and liberalisations have often undermined the access of poor people to basic services and have painfully increased the vulnerability of already weak economies. Privatization of sectors such as water or energy has sometimes limited the access of the poor to essential services. Companies in these sectors require large investments and thus are not always profitable, let alone in the short-run. Non-competitive selling of state companies or rushed privatizations has often led to underperformance of these sectors and the introduction of non-competitive monopolies. Sales have often been non-transparent and regulation and competition after sell-offs weak or non-existent.

In 2005 the World Bank and the IMF made their budget aid conditional on **on the liberalization and privatization of the Malian cotton sector**. Cotton privatization continues to be a condition of their lending today. Such conditions have at best failed to deliver for the poor and at worst have destroyed poor peoples' livelihoods. Liberalization of the cotton sector has exposed Malian cotton farmers to the heavily distorted world cotton market price. Prices have been in severe decline as a result of huge rich-country subsidies to their own farmers. The result: three million Malian farmers saw a 20 per cent drop in the price they received for their cotton in 2005. According to an unpublished study by the World Bank, this is likely to increase poverty by 4.6 per cent across the country.

In Zambia, the World Bank required that the the **state-owned Zambia Consolidated Copper Mines (ZCCM) should be privatized**. In 2000, ZCCM was sold to foreign investors. Privatisation increased the profits of the mining sector. However, this was a bad deal for the Zambian people, based on bad advice from the World Bank and IMF. The agreements made with foreign companies exempt them from covering most of ZCCM's liabilities (including employees' pensions) from paying most taxes, and from many national laws, for examples on environmental pollution. This prevented Zambian workers and, more generally, Zambian citizens to benefit from increased profits in the mining sector. The problem – as often – is in how this privatization was handled. As a result, the government, companies and aid donors face a crisis as communities on the Copperbelt express their frustration, through strikes, protests and the ballot

[2] World Bank: Review of World Bank Conditionality, September 2005.

box. A report by the Civil Society Trade Network in Zambia[3] attributes the legitimacy crisis to the widespread perception that “massive wealth is being generated by the mining as world prices for copper hit record highs but that, because of privatization, it is leaving the country before Zambians see significant benefits.”

In Nicaragua, the World Bank required to privatize the electricity sector in 1998 as a condition of their lending. Today the ramifications of that decision are still being felt by Nicaraguans. Union Fenosa, a Spanish firm, was the only bidder to run the distribution companies, so it bought an effective monopoly over electricity distribution. Bringing in private companies to run the electricity sector provision has not resulted in additional investment in electricity provision. Instead this investment has come from the state, who has taken on loans worth $23 million to finance investment in infrastructure. The privatization has however resulted in adverse affects for Nicaraguan consumers. The quality of the service has worsened. Severe power cuts have been more pronounced in the past two years. Spiralling costs have also adversely affected consumers. The bills of one family in the Montoya region of Managua showed an increase of energy consumption of 1187% in two months (this doesn’t make sense. Why did their consumption increase so much?), which in turn saw their charges for consumption increase by 2736% without spurious additional charges street lighting that was not delivered. In December 2006 the family owed US$1,836. The annual per capita income in Nicaragua is US$890.

Highly **sensitive policy reforms are also being promoted in fragile states** such as **Afghanistan**, where the World Bank is currently backing a policy which will lead to the **privatization of more than 50 state-owned enterprises** in the country over the next two years. This situation raises concerns about the potential social and political impacts of a rushed privatization process and the ability of the government to handle the transactions and the regulation and compensation necessary following the sell-offs. Around 90% of the economy is informal and unemployment is thought to be as high as one-third of the workforce. If the privatizations are to cause 14.500 job losses, then nearly $7 million would be needed to compensate these workers for one year, which would entail significant costs for the government and the donors. The Bank has failed to explain why these privatiszations are necessary now – it admits that the enterprises in question are not unduly burdening the Afghan public purse; and the economic benefits seem uncertain. Besides, such sensitive economic policy reforms should be accompanied by a public debate on the pros and cons of privatization. Afghan civil society and the new parliament must become more involved in this process if it is to be legitimate and responding to the needs of the Afghan population.

Privatizsation and liberalization are not good or bad per se. The issue at stake is that economic policy reforms should not be externally imposed nor induced, but they should be the result of national policy decision-making and debate among the relevant stakeholders in order to strengthen legitimacy of the decisions, as well as democracy and domestic accountability. Moreover, when taken at national level, economic policy reforms can take better into account the local political economy and more effectively contribute to poverty reduction.

Contractual terms of aid relationships: what are fair conditions?

Conditionality has proved to be ineffective when imposed from the outside. Therefore, mutual accountability rather than one-sided conditionality should be the framework of donor-recipient relationships. This is recognised by many scholars and in international commitments by the US and other governments, for example the March 2005 Paris Declaration on Aid Effectiveness. Eurodad and colleagues in other civil society groups have spelled out what we see as legitimate obligations which provide a reasonable guarantee that funds will be well-spent and which are effective in achieving this goal. In brief these are:

[3] Civil Society Trade Network in Zambia: For whom the windfalls? (2007): www.minewatchzambia.com/reports/report.pdf

- Due-process obligations, such as compliance with national democratic mechanisms for public consent; transparency – i.e. budget transparency – and disclosure of information; and accountability including, crucially to legislators.[4]
- Respect for internationally recognised standards, such as protection for human rights and the environment;
- Promotion of internationally agreed development goals, such as the Millennium Development Goals.

The failures of traditional economic policy-based conditionality have been recognised, leading to several proposals for new approaches which strengthen ownership and development effectiveness. One promising new approach, outcome-based conditionality, is now being adopted by the European Commission. This suggests linking disbursement to achieved or pledged development results, and encompasses, in principle, the potential to increase government ownership and link development programs to their impact on poverty reduction. It would also help measure the effectiveness of aid in delivering the internationally agreed Millennium Development Goals.

Aid donors should recognise that they cannot and should not control policy decisions in developing countries. Delegating policy decisions to sovereign governments and their peoples is the only possible way to trigger a positive circle of building capacities and responsibilities of national actors. ”Good governance” is only possible when we get rid of the wrong conditionality.

Conclusions and recommendations

The World Bank’s reform of conditionality is insufficient and going far too slowly. Good Practice Principles for the application of conditionality put in place after the 2005 Conditionality Review have not made any substantial difference in the numbers of legally binding conditions and have only brought about limited progress with regards to non-binding conditions. Moreover, the World Bank still attaches high priority to economic policy conditionality. This casts serious doubts about the Bank’s political will to eliminate this type of conditionality, which is particularly controversial for it has often damaged national economies, undermined government ownership and has had a harmful impact on the poor.

This situation demonstrates the World Bank’s inability to date to implement its own reform agenda. The Bank and the major governments who are currently considering increasing their financial commitments to the World Bank’s International Development Association must take action. As the 2005 Conditionality Review and Good Practice Principles are failing to deliver, World Bank shareholders should use the opportunity of the IDA funding round to get firm, specific and timetabled commitments from the Bank to reduce and clean up its conditionality figures.

In particular we would like to see the **World Bank** commit to strengthen the Good Practice Principles by:

1. Including as a key principle the commitment to end World Bank use of economic policy conditions in all of its IDA lending;
2. Increasing the transparency of World Bank conditionality, by ensuring that parliamentarians, civil society organisations and other actors are able to participate in key decisions about World Bank lending programmes, prior to their implementation;
3. Providing more predictable aid by assessing conditionality progress every three years rather than every year;
4. Revisiting the definition of ownership to ensure policies are country *selected* rather than there simply being government support for Bank selected policies;

[4] Eurodad welcomes the Parliamentarians' Declaration for Shared Responsibility in Sovereign Lending. www.debtdeclaration.org

5. *Properly* implementing the GPPs -by ensuring that all new development policy lending is subject to an assessment that verifies that the principles have been properly integrated into its design, and reforming staff incentives to achieve this;
6. Working with donors to ensure annual *independent* monitoring of these new improved GPPs, that incorporate the views of southern governments, CSOs and independent researchers;

IDA contributing governments

The British and Norwegian governments have taken formal positions against economic policy conditionality. We urge the US Congress to take a strong stand and to use its influence to press for an IDA 15 settlement that mandates the World Bank to implement the above reforms.